# US-SOVIET TRADE AND ECONOMIC RELATIONS: PROBLEMS AND PROSPECTS*

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*The paper that follows calls for some prefatory explanation, since it was written for an audience quite different from the BULLETIN's readership and at a historical moment in the relations between the two countries that has already, in the course of a mere several months, been superseded by the flow of events. The paper was prepared as a discussion paper for the Seventh Dartmouth Conference, which convened at Dartmouth College (Hanover, N.H.) in the first week of December 1972. Meeting approximately biannually since 1960,*

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*the Dartmouth Conferences have been non-official, bi-national gatherings of American and Soviet public figures (if the last phrase can be deemed to have comparable meaning on both sides) held with a view to improving mutual understanding and the relations between the two countries. The locale of the first meeting, as of this last one, was Dartmouth College; hence, the name. The author of this paper attended no meeting before the latest, and was the only professional economist--and one of only three or four sovietologists--on the American side.*

*Thus, the paper was intended for an audience that might fairly be called, from the vantage point of ACES, as consisting primarily of laymen, and of course was written for the benefit of both sides. A good dose of patience and indulgence is therefore requested of the professional reader.*

*The paper was written in early August, after the Moscow summit meeting in May but before the full magnitude of the Soviet grain crop failure and of Soviet grain purchases in the West became fully known to outsiders, and before the signing of the maritime and trade agreements between the two governments in October. And the conference itself met before the second devaluation of the US dollar and the consequent sharp jump in the free-market price of gold, a major Soviet export. To this extent some of the discussion in the paper is already dated.*

*In rereading the paper at the end of March 1973, I find little reason to change my mind on its main points. If anything, the mounting pressure on resources in the USSR and in Eastern Europe as a whole--in large measure but not entirely occasioned by last year's crop failure--seems to reinforce them. Nor have I seen good evidence to suggest that the*

*granting of MFN to the USSR by the US Congress (still uncertain at this writing) will in itself lead to a significant expansion of Soviet sales in this country. To the extent that such sales now pay higher duties, it will presumably increase Soviet dollar earnings. However, will MFN increase Soviet dollar earnings enough to cover the roughly $25 million per year for 29 years that the Soviet side agreed, under the Lend-Lease settlement agreed to at the time of the trade agreement, to pay for the privilege--at least until inflation renders the figure trifling? Moreover, the events since the beginning of this year--such as the further devaluation of the US dollar and the further upvaluation of the yen, the policy of the Tanaka government--seem to reinforce the impression that Japan has a very important role to play in a triangular exchange of goods in which the US and the USSR are the other two corners.*

## I

As the participants in this Dartmouth Conference know very well, US-Soviet merchandise trade is small by any yardstick. To be sure, US exports to the USSR have been rising steadily and rapidly in recent years, almost tripling from about $60 million in 1967 and 1968 to $162 million in 1971; but in 1971 they still represented only 0.37 percent of total US exports. US imports from the Soviet Union have been even smaller and, unlike exports, show no clear rising trend. They averaged some $56 million from 1967 through 1971; in 1971 they were $57.6 million, or 0.13 percent of total US imports. During 1972 there was a large jump in US exports. Even apart from the $1.2 billion wheat sale, other exports during the first 11 months amounted to $612 million--an almost fourfold increase--while imports came to $80 million.

This trade has been somewhat more important as seen from the Soviet side, but even so it has constituted only 0.7 percent of total Soviet foreign trade turnover in recent years.

Equally noteworthy is the re-emergence of a very large net export balance from the standpoint of the US. As we just saw, in recent years the United States has been selling two to three times as much to the USSR as it has been buying from it (and this ratio is about to increase further sharply). Moreover, this "imbalance" conforms to the historical multilateral pattern of trade between the two countries: we find it in the immediate post-war years, in the Thirties (i.e., after the onset of the Soviet Five-Year Plans), in the Twenties, and even in the years preceding the First World War.

If the re-emerging multilateral nature of US-Soviet trade is therefore no surprise, its persistently low volume remains to be fully explained. Unfortunately, the explanations that are usually offered do not entirely satisfy the economist who looks for more than superficial answers. Let us take first US imports from the USSR: it is sometimes alleged that the chief obstacle to their growth is the failure by the United States to accord most-favored-nation (MFN) treatment to Soviet goods, and conversely, that the extension of MFN tariff rates to Soviet goods would very markedly expand such imports. But do the facts support this view?

To begin with we might look at Soviet sales to Canada, the country that is economically most similar to the US. Since Canada, unlike the US, extends MFN treatment to Soviet goods, we might expect that they do better there. Yet this is not the case; e.g., during 1966-70 their share in total Canadian imports was on the average equally minute (0.1 percent) as in total US imports.[1] This suggests that the nature of the North American market may be more important than MFN in this regard.

[1]We may further note that nearly half of Canada's imports from the USSR in those years consisted of ginned cotton, a commodity that the US is not likely to import from the USSR.

Second, one can refer to the experience of the industrially developed countries of Western Europe, which also accord MFN treatment to Soviet goods. The fact that they import much more (in proportion to their total trade) from the USSR than does the US is in itself not conclusive in regard to the MFN question, because their imports from the USSR consist overwhelmingly of the kinds of raw and semi-processed commodities that--at least hitherto--have not been likely to find a market in the US even with equal tariff treatment (and, indeed, many of them are admitted duty-free to the US regardless of the country of origin).[2] As for more highly manufactured goods, it may be instructive to refer to a list of such goods that was given in a paper submitted by the Soviet side to Dartmouth VI. Because in the case of all these goods the full rates of duty (applicable to Soviet goods) are much higher than the MFN rates, the article implies that their importation from the USSR into the US would be considerably larger were it not for the tariff discrimination. The goods in question are: metal-cutting machine tools, electric motors, welding machinery, mining equipment, hoisting and carrying equipment, hydrofoil vessels, transistor radios, plywood, and motion pictures.[3] Yet, as it happens, none of these goods (with two exceptions to be presently noted) figures in anything but negligible amounts in the imports of Western European countries (or Japan) from the Soviet Union. Can we expect that these goods would enter in significant amounts into the US if the tariff differential against them were abolished?

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[2]A thorough analysis of the disadvantages borne by Soviet (and other East European) goods in terms of US customs duties will be found in: US Tariff Commission, Staff Research Studies No. 4, Anton F. Malish, Jr., *United States - East European Trade: Consideration Involved in Granting MFN Treatment to the Countries of Eastern Europe*, 1972 (see p.43 of this issue for extracts).

[3]M.I. Zakhmatov and H.V. Orlov, "Development of Soviet-American Relations," *Discussion Papers Presented at Dartmouth Conference VI*, n.d. The list is at the top of p. 22, col. 2. The article also lists a raw material, manganese ore; and a semi-processed commodity, iron. Both are imported into Western Europe from the USSR in relatively small quantities.

The two exceptions are plywood and motion pictures, which are imported into Western Europe from the USSR in significant amount. But the same two articles are also imported into the US from the USSR, both despite large tariff differentials. Indeed, during 1967-70, the US took as much as 15 percent of global Soviet exports of motion pictures--which would seem to suggest that tariff discrimination makes relatively little difference where the market demand is inelastic.

Lastly, so little is known abroad of the way in which export decisions are made by Soviet authorities--except that they do not follow the usual commercial criteria of private firms--that one cannot tell to what extent the lack of MFN treatment does in fact prevent larger Soviet sales in the American market.

In sum, for the various reasons just cited, it is not at all obvious that the lack of MFN treatment has been a major depressant of the level of American imports from the USSR in recent years.[4] At the very least, it seems to us, the MFN issue should not obscure the fact that there are other major economic and commercial hindrances to larger Soviet sales on the American market, obstacles that will not be removed by the granting of MFN to the USSR. (The same conclusion essentially applies in the case of the remote possibility of the USSR joining GATT.)

These economic and commercial hindrances have been discussed so often in the literature and at conferences[5] that only

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[4]The paper by Zakhmatov and Orlov also lists as a "hindrance to the development of trade" "the ban on the importation of many of our Soviet products (such as seven varieties of furs)." There are *no* prohibitions against the importations of any Soviet products that do not apply to the same products from any other foreign source, except the ban against the seven varieties of fur (which was introduced by legislation in 1951 and requires congressional action to be lifted). Prior to the imposition of the ban the varieties of Soviet fur affected by it were entering the United States at the rate of $6.7 million annually.

[5]See, e.g., the paper by the Staff of the Chase Manhattan Bank, "US-Soviet Economic Relations," *Discussion Papers Presented at Dartmouth VI.*

a brief listing need be given here. Soviet manufactured consumer goods encounter difficulties in the American market (as well as other Western markets) owing to a great many factors, such as design, quality, variety, packaging, inadequate publicity, post-sale servicing and spare parts, speed of response, adaptability to changes in taste and fashion, and so forth.

Industrial materials, such as chemicals, present problems of conformity to technical standards, reliability of supply, etc. Machinery and equipment also encounter difficulties connected with technical standards, servicing, and spare parts, and also because they may be designed with objectives in mind that are different from the interests of American business users.[6] Last but not least, there is the problem of diversion of goods for export to the West in the Soviet economy, in which resources are very heavily committed for domestic needs and for export to other socialist countries. Again, we may turn to Western Europe (and other advanced Western countries) for evidence that these problems have limited Soviet sales even in the absence of tariff disadvantages. Soviet exports to such countries continue to consist very largely of raw, crude and little-processed materials, in which cases many, though not all, of the above-listed difficulties are often not important. But since the US--at least so far--has not been in the market for purchases on a large scale of the kinds of raw and little-processed goods that the USSR supplies to other advanced Western countries, there is little wonder that US imports from the USSR have been small.

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[6]The last point is illustrated by two outstanding cases: jet aircraft and the turbodrill (an important Soviet development for drilling oil wells). In the past 15 years or so the USSR has had little success in marketing its jets in the West, in large measure because they are not sufficiently economical to operate by Western standards. As for the turbodrill, it was designed to meet a major Soviet objective, the mechanical *speed* of drilling; it failed in the American market despite considerable efforts to sell it here because it performed poorly in terms of the *cost* of drilling.

Turning now to US exports to the Soviet Union, *their* low level is frequently blamed on export controls. There is no doubt that the prohibition against the export of some commodities to the USSR, the uncertainties, delays, and costs attached to the obtaining of export licenses even where these are granted by the US government, and the prohibition of longer term credit, have tended to depress US exports to the USSR in some--probably significant--measure. But again, the economist who looks further at the facts finds these reasons less than sufficient in explaining the very low level of such exports. And again, he suspects that other economic and commercial considerations may have been of considerable importance in holding down this side of American-Soviet trade as well.

To begin with, the list of goods barred for export to the USSR has been drastically reduced in recent years and is now relatively quite short. For example, as one examines in detail the commodity composition of Soviet imports from all sources--in 1970, a total of 10.6 billion rubles, or nearly 12 billion US dollars at the then official rate of exchange--one is struck by the impression that the vast bulk of the enormous variety of goods that the Soviet Union buys in the world is such that US export controls do not apply to them. For example, in that year, the equivalent of some $2 billion worth of global Soviet imports consisted of manufactured consumer goods, which are not now and never have significantly been affected by US export controls; but only about $3 million worth came from the United States.

Even if one goes directly to the commodity group primarily affected by export controls, machinery and equipment, the same impression holds. In 1970, the Soviet Union imported over $4.1 billion worth of machinery and equipment, of which over $1.1 billion came from the West, and only $24 million from the US (as per Soviet statistics).[7] Of the total of Soviet imports of

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[7]According to US statistics, about $45 million.

machinery and equipment, over one-half--i.e., over $2 billion--consisted of types of machinery which are not generally barred for sale to the USSR by the US export controls, such as: hoisting and moving equipment; machinery for the food-processing, textiles, footwear, woodworking and paper-making, building materials, printing, and other "light" industries; electric calculators and typewriters ($70 million); agricultural machinery; and so forth. In other words, no more than one percent of all the machinery and equipment of the kind that would not be barred by US export controls that the USSR imported from all sources in 1970 came from the United States. Surely, therefore, export controls are not a sufficient reason to explain the low level of American exports of machinery--let alone all other goods--to the USSR.

Perforce, one falls back to the question of the competitiveness of American products. We do not expect that Soviet importers will prefer American products over others unless they are fully competitive on all scores.[8] They may not have been so in Soviet eyes. One may hope that the devaluation of the US dollar in 1971-72 and the relatively slow pace of inflation in this country will help our exports to the USSR in the near future (though their sharp increase is now chiefly in grains, a special case).

An important reason for the lack of competitiveness of American products in Soviet eyes has no doubt been the severe limitation on credit imposed by the Johnson Act of 1934. This Act, as is well known, prohibits credit (interpreted as longer-term credit) by any US entity, private as well as public, to any country that is in default to the US government. Clearly, its strictures apply primarily to capital goods exports. Given

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[8]Cf. Premier A.N. Kosygin in his speech before the Supreme Soviet on 24 November 1971: "Of course, the Soviet Union will approach trade with the United States by taking into account the real competitiveness of American industrial products in the world market."

the USSR's great interest in purchasing capital goods on credit, on which more below, and given the importance of this country as a potential seller of capital goods (including complete installations and the like) to the Soviet Union, it is very likely that the Johnson Act has seriously held down US exports to the Soviet Union. But even if this impediment should be removed in the near future, the prospects of American sales to the USSR will still rest largely on economic and commercial grounds. To these we now turn.

## II

As we have just seen, in selling to the Soviet Union, the United States is in competition with other countries of the West: with the major Western industrial countries regarding machinery and most other manufactured products, and with Canada, Australia, etc., in the sale of grain and other agricultural commodities. Hence, we must first ask: what factors determine the intensity of Soviet interest in buying from the West? What tends to heighten such interest and, given the purchasing power, to increase Soviet imports from the West? Broadly speaking, it is rising pressure on its own resources which can arise from various causes, such as the adoption of taut plans, or significant shortfalls in the realization of plans (for whatever reason, including a crop failure), or a major revision of priorities which necessitates such a great shift in resources that it cannot be effected quickly enough without resort to foreign resources. When one or more of these causes occur--and they often occur together--the other socialist countries may be of only limited help to the USSR, because their own resources tend to be fully committed, and also because they may be experiencing similar needs themselves. At such junctures the USSR becomes especially interested in the machinery, other goods, technology and credit that may be obtainable in the West. Soviet history offers many examples. The First Five-Year Plan is of course a

classic case in point when the USSR bought--outright or on credit--enormous amounts of Western equipment, industrial commodities, technology, and expert assistance. But the post-War period is equally instructive; witness the large purchases--often on credit--from the West in connection with the urgent expansion of the chemical industry in the late Fifties and early Sixties, the passenger-car industry and various branches of light industry in the later Sixties, the expansion of the maritime fleet, and so forth. Also the large imports of grain from the West in the middle Sixties, and now again in the early Seventies, reflect at once harvest deficits and the much-heightened emphasis on maintaining and improving the quality of the public's diet.

Turning to the present, the current Ninth Five-Year Plan (1971-75) is, to begin with, a very taut plan. It posits--even by recent Soviet experience--comparatively high targets in relation to the resources on hand; in other words, it assumes unusually high rates of growth of productivity of each of the major resources (labor, capital, equipment, materials) and an unusually quick rise in overall economic efficiency. This in turn depends in large measure on speeding up the rate of technological advance throughout the Soviet economy. It may be noted in passing that the greater tautness of the current Five-Year Plan compared with its predecessors derives not from any acceleration of intended growth rates but from the significant expected retardation in the expansion of the non-agricultural (especially industrial) labor force and, to a lesser extent, of the productive capital stock. Intensifying the pressure on capital funds is the prospect of developing the very rich natural resources east of the Urals, some of them in quite remote regions--a prospect that promises enormous long-run benefit to the Soviet economy but entails heavy capital outlay in the near future. (Indeed, much of this development is for the purpose of meeting existing or projected export commitments, especially to Eastern Europe.) In sum, the Plan implies a rising need of capital goods, materials, and credits from the West.

This would be so even without the disappointing results in agriculture, especially during 1972. With the serious shortfall in the grain crop--and its implications for the balance of payments--there is little doubt that Soviet resources, both domestically and internationally, will be under considerable strain to meet the Plan's targets. In line with what has just been said, this implies a much-heightened interest in imports of various kinds from the West and in credits from the West.

The immediate concern, of course, centers on imports of grain. One must bear in mind not only domestic requirements for both animal and human consumption but also the USSR's grain export commitments of 7-8 million tons (equivalent to $500-600 million at world prices) per annum. We have already witnessed large purchases of grain in the US, France, Canada, and Australia beginning in 1971. From the US alone, the USSR has purchased some $140 million worth in late 1971 and $750 million worth in July 1972, the last on medium-term credit and for delivery over three years. As of this writing, press reports indicate that the Soviet Union may import as much as one billion dollars worth of US grain between mid-1972 and mid-1973, a large part of it apparently for cash payment. Not only would such grain purchases increase the rate of US exports to the USSR many times over what they have lately been, but they also represent (together with grain purchases from other Western countries) a very large amount in relation to the recent rate of Soviet merchandise imports from the industrialized West (about $2.8 billion in 1970). It is quite likely that the corresponding hard currency outlays--immediately and a little later for repayment of the medium-term credits--will significantly restrict Soviet ability to import other goods from the hard currency area for several years, and alternatively will increase Soviet interest in long-term credits in the near future. To repeat, this is at a time when the current Plan implies a significantly rising need to import equipment and industrial materials from the West.

But what are the provisions of the Ninth Five-Year Plan itself with regard to foreign trade? These (formulated before the setback in agriculture) seem to be rather cautious and moderate, particularly as to what they imply for trade with the West. Total foreign trade turnover (with all countries) is to increase by only 33-35 percent over the preceding quinquennium,[9] somewhat less than the planned rise in national income. The most specific data pertain to trade with the other countries of the Council for Mutual Economic Assistance (CMEA);[10] the turnover of this trade is to increase by 50 percent. Notably, the net importation of machinery and equipment by the USSR from other CMEA countries is to increase by almost 50 percent and to comprise, for the five years, the equivalent of $8.5 billion (at the official rate of exchange now in effect).[11] Moreover, the other CMEA countries are to share in providing capital for a series of specific investment projects within the Soviet Union aiming to expand capacity to produce certain fuels and raw materials that figure importantly in Soviet exports to Eastern Europe. The total of this projected capital flow is not mentioned. In a sense, it is a qualitatively new phase within the CMEA, a development that is quite consistent with our impression of a growing scarcity of investible resources within the Soviet economy in relation to medium-term targets and objectives.

As regards trade with the industrialized West, the Plan is very vague. One can infer from its figures that trade with all non-socialist countries (within which trade with the industrialized

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[9]This percentage increase, as the others mentioned in this paragraph, compares the whole current five-year period (1971-75) with the whole preceding five-year period (1966-70), and is presumably at current prices.

[10]Bulgaria, Czechoslovakia, the GDR, Hungary, Mongolia, Poland, and Rumania. Cuba joined in July 1972; she is not subsumed under CMEA in this paper.

[11]Soviet exports of machinery and equipment to other CMEA countries are to increase by 85 percent, Soviet imports, by 65 percent. But because the imports are now about twice as large as the exports, the net import balance will still increase by about 50 percent.

West comprises over one-half) will increase very moderately, perhaps by less than 20 percent, comparing this five-year period with the preceding one. This is probably a cautious estimate. It would surely be too "conservative" a forecast for Soviet trade turnover with the industrialized West alone; indeed it would increase by just this percentage if it simply remained on the 1970 level. Moreover, the already signed purchase contracts and trade agreements point to a considerably larger increase than 20 percent for the quinquennium--and the Plan carries a strong hint of it in fact.[12] But how will the USSR pay for this increase in imports from the hard currency area?

In the short run, credit may finance much of this increase; but sooner or later it will have to be paid by an expansion of exports. As we have seen, the bulk of Soviet exports to the West consists of raw, crude, semi-processed materials and there is little doubt that this will continue to be the case in the proximate period. The prospects of a large expansion of these exports in the *long run* are good. As the rich eastern deposits of petroleum, natural gas, non-ferrous metals, timber, and goods are opened and exploited on a large scale--and as these goods become ever scarcer in the industrialized West (including Japan)--the USSR will find itself in a strong position to earn hard currency. Moreover, the rising prices of fuel on the world market work to the advantage of the USSR. But most of this development will require enormous capital investment and a good deal of time. In the nearer term a large increase in such exports is more problematical, at least without massive capital assistance from the West (on which more presently). As we have noted, under the current Plan the Soviet Union is experiencing growing pressure on its capital, labor, and material resources from domestic requirements and on account of commitment to its CMEA partners. Also, some of the exports of such materials are already directly committed in payment of prior credits from the West; e.g., the

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[12]This is to say that total trade turnover (with all countries) is also likely to increase more than the projected 33-35 percent.

export of natural gas in exchange for large-diameter pipe from West Germany.

Gold is another staple Russian export whose sharply rising prices have helped the Soviet balance of payments with the West. The $200-300 million annually that the USSR has been earning on the average at the old price from its irregular gold sales should now bring in something closer to $500 million as long as the present high free-market price lasts. (The rate of gold mining and the size of its gold stock are not revealed by the USSR.)

We have already taken note of difficulties that the Soviet Union has had in marketing manufactured consumer goods and various kinds of machinery and equipment in large amount in the West.[13] Moreover, in this regard the pressure of domestic demand and of commitments to CMEA countries is likely to be felt strongly.

Clearly, the main answer to an increase in Soviet purchases in the West in the next few years is large-scale credit of some sort. Apart from short-term commercial credit for the purchase of non-capital goods, which is hardly at issue at this time even with US exports, and certain special cases,[14] what is chiefly

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[13]It is assumed here that the organization of production and exporting on the Soviet side remains essentially unchanged in the near future. However, should Soviet institutions evolve in the direction of greater sensitivity and adaptability to foreign (Western) demand, as has already happened in Hungary, our estimate in regard to capital goods and manufactured consumer goods may be overly cautious. That there is a potential for greater responsiveness in Soviet exports is demonstrated by the "local maritime trade" (*priberezhnaia torgovlia*) between the Soviet Far East and Japan. Under this arrangement, now several years in effect, the local Soviet authorities can trade directly with Japanese organizations on their own initiative and in pursuit of local interests. While exports are limited to goods of minor importance, this trade has been quite successful within its very narrow limits.

[14]Such as US government financing of a part of Soviet grain purchases or possible hard-currency loans obtained by the CMEA's International Investment Bank.

in question here is long-term credit for the purchase of capital goods by the seller (usually with some financing, guarantee, or insurance by his government). The arrangement often sought by the Soviet side--what may be called "barter on time"--is one whereby the repayment to the seller-lender is not in cash but in deliveries of goods strung out over many years, goods that are often the direct products of the capital projects in question. The advantages of the barter-on-time arrangement for the Soviet side are fairly obvious, not the least among which is the avoidance of the transfer problem for servicing the loan in the future. The advantages to the Western firm are not nearly as evident; one feels that somewhere the Soviet side must be making a concession in order to "sell" the deal.

The interest rate is often at issue, especially in periods, such as the present, when money is expensive in the Western financial markets. It must be borne in mind, though, that within the Soviet Union capital commands a much higher return. Thus, the official formula currently in effect requires a 15 percent return on capital as part of the wholesale price of a good, while another official regulation requires a minimal return of 12 percent (and higher in some industries) before capital may be substituted for current inputs.

As publicized in the press in recent months, the Soviet Union is apparently prepared to enter into a good number of very large agreements with Western firms--or consortia--for the development of natural resources and construction of pipelines, etc., on a barter-on-time basis. It may be noted that once the deliveries in repayment are completed (or perhaps even before that) the USSR will have greatly expanded its capacity to earn foreign exchange by exports of such commodities to the West. On the other hand, it is not clear how far Soviet authorities are prepared to go to incur further debts that will have to be repaid in hard currency rather than in predetermined deliveries of goods. By some informal estimates (for there are no official data on this score) the aggregate of the indebtedness

already incurred in recent years now perhaps exceeds $2 billion, with the annual service charges in the order of several hundred million dollars.[15] If the latter figure is not too incorrect, this means that debt service is equivalent to approximately ten percent of Soviet exports to the industrialized West, or to the larger part of the Soviet proceeds from gold sales even in the present favorable market.

Before turning to the prospects of American-Soviet trade one must take note of the potential for Soviet-Japanese trade, which is at this time surely one of the greatest yet-to-be-realized trade potentials in the world. But to be realized it may take a good deal of Japanese (and other?) capital, as the Soviet side seems to have in mind. Surely the raw materials of the Soviet Far East and Siberia present not only a great source of supply to Japanese industry but also a very important prospect for the earning of large hard-currency balances for the USSR, as already has been the case to some extent.[16] It would seem that Japan may yet play a very important role in a triangular flow of merchandise involving the USSR on the one side and the US on the other.

## III

Returning now specifically to US-Soviet trade, there is little doubt that on purely economic grounds--i.e., on grounds of comparative advantage in production and consequent gains from trade--the long-run prospect for much more active trade between our two countries is good. This is not just because

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[15]This does not take into account the credit for grain purchases as per the above-mentioned agreement of July 1972.

[16]Japan emerged in 1970 as the Soviet Union's largest "capitalist" trade partner. The Soviet export surplus with Japan varied between $100 and 200 million during 1967-69, but declined to $23 million by 1971. [Addendum: Soviet trade turnover, in rubles, with Japan increased by 10 percent in 1972, but was overtaken by the turnover with West Germany (*Pravda*, 9 March 1972)].

ours are the two largest economies in the world--after all, the larger an economy the less it is in need of trade--but because the relative cost structures will continue to be strikingly different in the two countries for quite some time yet, thus inviting mutual gains from the exchange of goods. Labor, including highly skilled labor and technical talent, is likely to be cheaper in real terms in the USSR, while investable capital (in the real sense of foregone alternatives) is likely to be cheaper here. Both of our countries are blessed with rich natural resources; but they are not quite the same, either, thus providing possibilities for exchange. Moreover, the difference in economic systems need not only inhibit trade, as is often assumed; it may also stimulate trade insofar as it contributes to differences in relative costs between the two countries. This exchange and trade can of course take many concrete forms: ordinary and unrelated imports and exports; barter arrangements of various kinds (though often these will be less interesting from the American point of view); co-production arrangements and various other joint ventures, where there are so many possible forms that it is very difficult to generalize about them; the sale, purchase, and exchange of technology (licenses); and so forth. In short, there are many opportunities for businessmen on both sides to get together in a mutually profitable way (even if the USSR does not grant more autonomy to its producing enterprises to enter into direct relations with foreign firms). As we stressed at the beginning of this paper, the US-Soviet trade "has no place to go but up" and may well become a more significant economic phenomenon from the standpoint of both countries.

But these are fundamental and long-term considerations. They must be qualified by the uncertainty (on the part of outsiders) regarding the extent to which comparative-cost considerations in fact enter into Soviet calculations for trade with the West in general and the US in particular. Certainly in the past this has not been always so.

In the nearer future, Soviet readiness to import from the US is more likely to be determined by the sorts of considerations outlined above: immediate pressure on the economy's resources within the context of the current Plan, commitments *vis-á-vis* other members of the CMEA, and major single events, such as crop shortages. And, of course, the relative competitiveness of American goods.

To be singled out are two American exports: grain and capital goods. Although the very large US exports of grain to the USSR that we are currently witnessing are probably a transitory phenomenon, smaller but still quite substantial grain exports may well continue for some time owing to the internal demand and the particular problems of agriculture in the USSR. The very large sales of American equipment that are now bruited about--which still depend on the resolution of a number of difficult problems of financing, etc.--may also be only a transitory phenomenon on this scale, but a regular feature for the indefinite future on a more modest but still very substantial scale, if the obstacle posed by the Johnson Act is successfully resolved.

That massive development of Soviet natural resources with the aid of American capital and technology--say, on a barter-on-time basis--can be mutually economically beneficial to both of our countries is hardly to be doubted as a matter of principle (though not every project may be able to meet this test). That such projects are also a way to generally improve the relations between the two major powers is much more problematical. Large-scale indebtedness by one country to another, with deep involvement of both governments, is not necessarily a guarantee of peaceful relations and good will in the longer run.

But to return to trade as such. Soviet purchases in the US have to be paid for in cash, or the credit has to be repaid in time. Already, the Soviet Union is paying for most of its

purchases here through proceeds from exports to third countries; i.e., the trade is heavily multilateral. Moreover, as we have argued, even in the event that full MFN treatment is accorded to Soviet goods, a rapid increase of Soviet sales in the US in the next few years is very unlikely. (Should the just-mentioned capital projects be realized, the materials flowing from them would presumably be largely earmarked for the repayment of the capital advanced.) At the same time US exports to the Soviet Union are rising steeply. Thus, the prospect is for an even greater imbalance in US-Soviet trade, i.e., for the trade to be even more deeply integrated into the multilateral network of world trade. As we have seen, this is also a return to the historical pattern of commerce between our two countries, and should be seen as a normal phenomenon that enhances the prospect of economic benefit for both partners. However, it does mean that the USSR will have to generate a growing positive balance in its trade with the rest of the hard-currency area in order to finance its growing purchases here and to repay the credits that may be extended in the meantime. In this sense, the future of US-Soviet trade is intimately related to the future of Soviet trade with Western Europe and Japan. With time, the latter may turn out to be of particular importance. The enormous trade potential across the Sea of Japan may harbor one of the main keys for the long-term expansion of US-Soviet trade.